The Role of the Government in Dynamic Economic Development Process

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Behind the Asian Miracle

For a very long time, a successful economic development of Asian countries was considered to be an extremely difficult, if not impossible, task. The efforts required to change Asia's social, economic, and possibly psychological structures seemed so daunting that, about 30 years ago, no sensible scholar expected the remarkable progress in the region which was to come. Thus, when an eminent economist and sociologist of Sweden, Professor Gunnar Myrdal, predicted an extremely bleak outlook for Asia in his book **Asian Drama** (1968), nobody questioned his proposition. He mainly focused on Burma (now Myanmar), Ceylon (now Sri Lanka), India, Indonesia, Malaya (now Malaysia and Singapore), Pakistan, the Philippines, and Thailand.

A quarter of a century later, however, the World Bank, the leading multilateral development bank, published a book, **The East Asian Miracle: Economic Growth and Public Policy**, in which it detailed the extraordinary economic development of East Asian countries. In the book, the World Bank told the world the story of how eight countries and economies in East Asia — Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; Singapore; Taipei,China; and Thailand — had succeeded in attaining rapid per capita income growth. From 1965 to 1990, the per capita income in these countries grew at an average annual rate of 5.5 percent. These eight economies grew roughly three times as fast as Latin America and 25 times faster than Sub-Saharan Africa. The World Bank also found that income distribution in these countries improved during the period. In recent years, other Asian countries such as People's Republic of China, India, Lao People's Democratic Republic, Sri Lanka, and Viet Nam have also been recording high growth rates.

Various factors have been conducive to the Asian Miracle, among them the strenuous efforts of the people and well-chosen governmental policies. One can look at these success stories both as the results of sound development management and as examples of good governance.

The Role of the Government as a Center of Governance

Though there are many aspects to what we call governance, I think the role of the government in development process is at the center of the issues. If Asian success stories are partly the result of successful governmental policies, as they are certainly are, there should be right answers, or at least clues to right answers, pertaining to the proper role of the government for successful economic development in the experiences in the region.

Thus, in spite of the fact that the role of the government has become a popular subject, a subject that many eminent scholars and officials have recently addressed, I am much tempted to focus on the role of the government when we discuss the issue of governance.

Traditional Dichotomy in the Analysis

I believe that the traditional dichotomy in which the role of the government has been studied is thus far insufficient. It seems that, in discussing the role of the government in the literature of economics, people tend to put forward their argument, explicitly or implicitly, based on dichotomy in many ways.

For example, many economists argue that governmental measures are discretionary and oppose market forces. The assumption is that the government always acts against market forces and that the government and the private sector are each other's enemy by nature. The popular expression "market-friendly government" is only possible if you assume that the government and the private sector are opponents by nature.

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However, as I take up in detail later, the government and the private sector have common goals in many areas. For example, they have common interest in realizing a high growth with low inflation. Realization of safe and comfortable life for people should also be one of their common aims. Indeed, as the government is chosen, directly or indirectly, by the people, it is wrong to assume that the goals of the two are different, let alone that they are opponents.

Many economists argue that government policy measures are by nature against market forces and that its discretionary intervention in the markets is to be avoided as much as possible. Not necessarily. Markets fail for various reasons. Contrary to assumptions made by many economists, information is not equally shared, market participants are not always rational, and they are not always experts on the subject. Sometimes, market forces point to short-term interests, which may not coincide with long-term, hence ultimate, interests. Furthermore, the existence of externalities and the infant industry argument are also used to verify the insufficiency of market forces. In such cases, interventions by the government are called in for the benefit of the society.

Based on the experience in Asia, or indeed in any region where success has been achieved in economic development, policy recommendations and specific policy measures based on such dichotomy are essentially mistaken.

The government and the nongovernment sectors have basically common goals. As I argue later, they have to work together to identify optimum development policy aims for their country and policy measures to attain these goals.

In sum, so long as we base our analysis on false assumptions — that the government is a necessary evil, that the government and the private sector are enemies by nature, and that the smaller the government, the better — we may not be able to realize the full potentialities of the country.

Government Industrial Policy

Next, let me touch on the often undue criticism of, or prejudice against, government industrial policies. There are many cases in the region where governments have taken proactive roles in introducing strategically important industries to their countries. Also, one may encounter occasions when governments have helped those sectors with potential comparative advantage in the economy. Some of these policies were successful and some were not.

Indeed, it is not an easy task to support specific industries with both comparative advantage and strategic importance for the development of the country. It is important to avoid making mistakes in the following three processes.

- **Policy aims or policy targets.** The target of the industrial policy should be correctly chosen. One must examine which industries are worth supporting under the circumstances surrounding the country. That specific industry should have comparative advantage in the country. Also, one should estimate whether, by the time the specific industry matures, its competitors in the rest of the world would have become more competitive or not. The choice of the industry must also reflect the present. A strategically important industry in 1950s may not be the same in 1960s. Even if your neighbor was successful in choosing the shipbuilding industry for a strategically important sector in the 1960s, you may be unsuccessful choosing the same industry in the 1970s. The correct choice of policy targets is not easy.

- **Optimal policy measures.** Realization of the specific policy targets under specific circumstances should be optimal. Again, the choice is not easy. Countries are different in endowment. Demographic structures are different. Educational systems are different. Social structures are different. Indeed, the cultures themselves are different. You must find optimal sets of policy measures that best fit the country at the time. There is no guarantee that measures adopted in other countries are suited for your country.

- **Timely implementation.** Even if policy aims are correctly chosen and the measures best suited for the country, failure to implement the measures in a timely fashion cannot ensure the expected results. Factors such as political complications, social disturbances, and social unrest can prevent timely implementation of the measures.

In sum, industrial policies may fail should any of these three processes fail.

The important point is that cases of failure should not be quoted as evidence of the ineffectiveness of industrial policies. Such cases only exemplify the difficulty of satisfying all three conditions at the same time. We should not confuse the case of failure of a specific industrial policy with ineffectiveness of the policy per se in economic development.

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Unfortunately, however, many arguments are found in the literature of development economics where these two are not distinguished. By quoting failure examples of specific policies of specific countries, the argument is often made that because industrial policy per se is ineffective, a case can be made for a smaller role for the government.

The Time Factor

A need exists to incorporate the time factor fully in policy for successful economic development. The role of the government can be more positively evaluated if the time factor is taken into consideration.

In other words, development policy should be formulated based on dynamic terms so that consideration of time is considered in various aspects. So far, dominant development policy has been based unsatisfactorily on comparative statics, which is extremely insufficient, because economic development policy aims at growth over a period of time.

Traditional theory assumes that in developing countries, the existing circumstances are fitted to economic development as in developed countries. In fact they are not.

The traditional theory of economic development does not assume change over time. And yet the aim of economic development policy is to realize changes (i.e., to attain faster growth with more equitable income distribution).

It assumes that a country's citizens have a constant set of indifference curves, or tastes, that ensure growth, and that the purpose of economic policy is to realize successful development based on that set of indifference curves.

They may be wrong. For successful development, the indifference curves must be addressed. Tastes must be changed. For that purpose, the government has a role to play.

For example, for a sustainable economic development, you have to agree that savings are important and that a higher savings rate is desirable. To attain a higher savings rate, people have to reduce their consumption patterns. In order to do that, the government can offer a forum through which people understand the need for change in consumption patterns. The government has to create environments which help people save more. A countrywide network of savings institutions would help, as would incentives for savings.

The traditional theory of economic development argument also assumes that conditions are the same in different countries. It implicitly assumes that in developing countries the existing circumstances are fitted to economic development as in developed countries. In fact they are not. Underdevelopment is partly the result of the existing environment. For economic development, the surrounding circumstances must be changed, and the government has an active role to play, either as a prime mover or as a mediator.

Another shortcoming of traditional economic theory is that it does not take into consideration the time required for successful economic development. Because the attainment of high growth from an undeveloped starting point requires considerable time, the coverage of development policy should be long enough to realize it. The time required for attaining success varies depending on the specific policy aim. If it is desirable to reduce demand in order to cope with external imbalances, i.e., deficits in balance of payments, government expenditure must be reduced, taxes increased, and monetary policy tightened. The effects of these policies will become visible after about six months.

If the economic structure itself is changed, e.g., deregulation of markets, the positive effects will reveal themselves after two or three years.

It takes many years to change people's behavior. Sometimes it is necessary to wait a long time for demographic changes to occur.

These considerations underscore the importance of incorporating a time factor in the establishment of a successful economic development policy, which in turn highlights the importance of the role of the government.

The Role of the Government in Dynamic Development Process

The government has a very important role to play in the dynamic development process.

First, in choosing policy aims, the people, and indeed the government itself, might not fully know which policy aims are best suited to the attainment of long-term growth. The government is in a position to show people alternative policy aims based either on their own analysis or following the advice of such multilateral development banks as the ADB. People in the private sector may well have different ideas. The government then can offer opportunities to exchange views on policy aims through establishment of a board. Through discussions on the board, which are open to the public, both the government and the people can deepen the analysis for desirable policy aims. The general public will understand what is at stake and offer comments on the issues taken up on the board. Public participation is popular and makes people conducive to selecting choices likely to be successful, and ultimately, to supporting the implementation of measures that will realize the policy aims.

Second, a similar role is expected for the government in choosing policy measures. The government may propose specific measures or offer opportunities to find the best measures to realize the policy aims. Because policy measures largely hinge on cultural, economic, and social structures of the country, successfully reflecting the will of the people is important, and the government can play a vital role.

Third, for timely and successful implementation of these policy measures, the role of the government along the lines described above is expected. If the people have good understanding of the legitimacy of policy aims and the need for the policy measures to realize them, these measures will be timely implemented, and a successful development policy will then be assured.

Observed from a slightly different angle, the government has also important roles to play in the dynamic development process.

In the dynamic development process, the participation of the people, the predictability of the system, and the transparency of information — all important ingredients of good governance — are essential.

Governments must ensure economic, social, and political stability. Only in a stable country can people establish the medium- and long-term plans essential for sustainable growth, and hence for the economic development of the country.

Thus, in the dynamic economic development process, the government is expected to play a more important and positive role than that preached by traditional theory.

It is noteworthy that in order for the government to play these expected roles sufficiently in the dynamic development process, the participation of the people, the predictability of the system, and the transparency of information — all important ingredients of good governance — are essential.